UNITED GUARANTY.

Office of the Comptroller of the Currency
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Washington, DC 20219
Docket No. OCC-2011-0002
"Credit Risk Retention"

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1411

Mr. Robert E. Feldman
Executive Secretary
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Attention: Comments
RIN 3064–AD74

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
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File No. S7-14-11

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Attention: Comments/RIN 2590-AA43

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Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, SW
Room 10276
Washington, DC 20410-0500
Docket number: FR-5504-P- 01
"Credit Risk Retention"

Re: United Guaranty's Comments on Credit Risk Retention

Ladies and Gentlemen:

United Guaranty Corporation is pleased to comment on the notice of proposed rulemaking (NPR)[14] issued by the Board of Governors of the Federal Reserve System (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Securities and Exchange Commission (SEC), Department of Housing and Urban Development (HUD) and Federal Housing Finance Agency (FHFA) -- collectively referred to herein as "the Agencies" -- to implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[15]

Since 1963, United Guaranty has provided insurance products and services to mortgage lenders of all sizes. Subsidiaries of United Guaranty provide mortgage guaranty insurance to protect lenders against mortgage credit losses. At the end of the first quarter of this year, United Guaranty had $107.4 billion of first-lien insurance in force in the U.S. In addition to mortgage insurance, United Guaranty offers a wide range of risk management and financial services to help lenders protect their investments. United Guaranty is a subsidiary of American International Group, Inc. (AIG).

As a provider of private mortgage insurance (MI), United Guaranty is dedicated to ensuring sustainable home ownership for creditworthy borrowers who lack the funds for a sizeable downpayment, especially those first-time homeowners and low- and moderate-income borrowers for whom MI is essential. United Guaranty's business model puts private capital at risk under disciplined risk management to promote sustainable home ownership across the country as well as to place investment quality mortgages into the secondary market.

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[14] Interagency Proposed Rule, *Credit Risk Retention*, 76 Fed. Reg. 24090 (Apr. 29, 2011) *available at* http://edocket.access.gpo.gov/2011/pdf/2011-8364.pdf.

[15] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (2010).

We fully support the Agencies' desire to reduce risk in the mortgage finance industry. However, we believe the proposed qualified residential mortgage (QRM) requirements are too restrictive and will have the unintended negative consequence of reducing mortgage financing for creditworthy borrowers without any material corresponding reduction in the probability of default.

United Guaranty will demonstrate with the extensive data provided in this letter that a sizeable downpayment is not the only or the best predictor of residential-mortgage credit risk. The best predictor of loan performance is a multivariate analysis that takes into account the interaction of several risk variables. Loans with high loan-to-value (LTV) ratios and backed by properly underwritten MI perform at least as well as loans with low LTV.[16] We thus urge the Agencies to delete from the definition of a (QRM) the proposed twenty percent downpayment requirement for purchase loans, as well as the very significant downpayment requirement proposed for refinance mortgages and add a requirement that mortgage insurance be in place for all QRMs with LTVs above eighty percent. Data shows that the proposed restrictive criteria are not required for prudent lending and unnecessarily eliminates financing for creditworthy borrowers who lack substantial downpayments. They will also inhibit the recovery of the U.S. mortgage market, now particularly dependent on first-time buyers and other borrowers with minimal cash resources to absorb the approximately 1.8 million[17] homes in the "shadow" inventory following the national mortgage crisis. With proper underwriting and MI, even loans with a minimal downpayment (i.e. loans with 97% LTV) can be investment quality.

Executive Summary

United Guaranty respectfully presents data in this letter illustrating that the presence of properly underwritten private MI on high LTV loans reduces the risk of default and thus must be included in the QRM to meet Congressional intent. United Guaranty urges the Agencies to:

- revise the QRM to permit high-LTV loans to qualify as QRMs if they are backed by private MI; and
- eliminate hard-coded underwriting standards in favor of a dynamic look at multiple risk characteristics that more effectively reduce the risk of default.

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[16] See Exhibits A-1, A-2 and A-3.

[17] CoreLogic, *CoreLogic Reports Shadow Inventory Declines Slightly, However, Nine Months' Worth of Supply Remains* (Mar. 2011) *available at* http://www.corelogic.com/uploadedFiles/Pages/About_Us/ResearchTrends/CoreLogic_Shadow_Inventory_March_2011_FINAL_033011.pdf

A system that successfully manages the risk of mortgage default should incorporate the following four capabilities:

- Accurate evaluation of the risk level of each individual loan;
- Underwriting of each individual loan at the time of origination;
- Active management of mortgage originators to promote a quality manufacturing process; and
- Agility to react to changing macroeconomic conditions by adjusting underwriting guidelines.

That system, however, must do more than just successfully reduce the frequency of default. It must also provide sufficient access to credit. The perfect system would allow origination of 100% of "good mortgages" with an acceptable risk of default and at the same time prevent origination of 100% of "bad mortgages" with an unacceptably high risk of default. The system in place leading up to the mortgage crisis clearly allowed origination of too many "bad mortgages." The system proposed by the QRM, on the other hand, would not only prevent origination of some "bad mortgages," but would also prevent origination of too many "good mortgages." The key to a successful mortgage origination system is to accomplish both objectives at the same time.

In order to accomplish these objectives, as the Agencies recognize, financial incentives must be aligned with the production of "good mortgages." The MI industry is uniquely positioned to identify and only agree to insure "good mortgages," because their capital is in the first loss position. Moreover, MIs are the only party in the mortgage origination chain that takes a second look at the quality of loans originated and compliance with prudent underwriting standards. Even if regulating underwriting standards did produce the desired result, there is no party other than MIs to enforce compliance with those standards. Investors do not have access to the right information or the right expertise to analyze each individual loan as part of their investment decision, but MIs do. Finally, MIs have specialized risk management expertise that allows them to apply flexible and quickly changing underwriting standards in response to macro-economic changes.

I. MI Is Real Private Capital At Risk

Throughout this comment letter, United Guaranty provides the Agencies with analytics on the current condition of the U.S. private mortgage insurance industry. The U.S. private MI industry had $759 billion of insurance-in-force as of December 31, 2010,[18] protecting 7.1 percent of all U.S. single family, first liens then outstanding. Private MI is substantively different in many respects from monoline

[18] Mortgage Insurance Companies of America (MICA), *MICA Issues Monthly Statistical Report: Insurance in Force Remains Strong* (Dec. 30, 2010) *available at* http://www.privatemi.com/news/statistics/detail.cfv?id=172.

bond insurance, most notably because its regulatory structure is truly monoline and limits mortgage insurers to providing only residential-mortgage insurance, barring investment in assets with risk correlated to those backed by MI.

Importantly, MI is in a first-loss position (generally the first 25 percent of the loan balance at default). This "skin in the game" effectively aligns mortgage insurers with borrowers, lenders, investors, and ultimately the taxpayer. Thus, MI is not only hard private capital at risk to ensure incentive alignment with both borrowers and investors, but it also prevents structuring or other evasions of exposure to mortgage credit risk.

Further, MIs must be well capitalized and adhere to state department of insurance requirements regarding capital and claims-paying ability. These requirements include a countercyclical reserve and limits on counterparty exposures.[19] An additional benefit of state insurance regulation is that an MI's counterparty status can be validated by securitization sponsors with a status certificate of good standing issued by the applicable department of insurance. MI is thus a state-regulated, industry-capitalized form of credit risk transfer that poses none of the regulatory arbitrage or other problems highlighted in studies of this sector by global regulators.[20]

II. Successful Management Of Mortgage Risk Must Be Accomplished By Analyzing Multiple Characteristics To Evaluate The Risk Profile Of Each Individual Loan

A. The Proposed QRM Does Not Accurately Evaluate the Risk Characteristics of Each Individual Loan

The proposed QRM requirements attempt to accurately capture the risk level of each individual loan by regulating underwriting guidelines. Most of the guidelines listed address prudent lending ideals, but are not real drivers of the risk of default. Of the guidelines listed, the two primary characteristics that drive the risk of default are LTV and DTI. While the current definition of QRM will certainly exclude some unacceptably risky loans, over reliance on LTV and DTI alone will not accurately capture the risk profile of an individual loan. Instead, a multitude of characteristics that drive the risk of default must be considered. Moreover, excluding loans that exceed only one of the permissible thresholds (univariate fatals) will not accurately capture the risk profile of an individual loan. Therefore the proposed QRM

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[19] See Interagency Proposed Rule, *supra* note 1, question 112(a).

[20] The Joint Forum, *Review of the Differentiated Nature and Scope of Financial Regulation - Key Issues and Recommendations*, (Jan. 8, 2010), *available at* http://www.bis.org/publ/joint24.pdf.

requirements are not effective, in that they include "bad mortgages" and exclude "good mortgages."

While LTV and DTI are predictive of the risk of default, other variables are also predictive, including:

- Credit score;
- Loan purpose: purchase or refinance;
- Property Type: single family, condo, manufactured home;
- Loan type: fixed versus ARM;
- Loan term;
- Origination channel: retail, correspondent, broker;
- Quality of lender manufacturing process;
- Self-employed indicator;
- Prior bankruptcy indicator

We illustrate through the attached exhibits that the risk of default varies widely amongst QRM eligible loans, depending on the presence or absence of other predictive variables. Compare the following two examples from Exhibit A-1:

Loan A: 80% LTV, 36% DTI, 700 credit score, purchase mortgage for a single family residence in South Bend, Indiana, 30-year fixed mortgage originated in the retail channel by a lender with an average quality manufacturing process, no prior bankruptcies and not self-employed. The claim rate[21] for Loan A in a non-stressed economic environment is 0.9%. The claim rate in an extreme stressed economic environment (like the loans originated in 2006-2008 period experienced is 4.1%.

We will refer to Loan A throughout this comment letter as the "normal QRM scenario." At the upper boundary of the LTV and DTI variables, the other variables considered are neutral.

Loan B: 80% LTV, 36% DTI, 660 credit score, purchase mortgage for a condo in Daytona, Florida, 30-year fixed mortgage originated by a broker and sold to a lender with a lower quality manufacturing process, self-employed borrower with a prior bankruptcy. The claim rate for Loan B in a non-stressed economic environment is 10.1%. The claim rate in an extreme stressed economic environment is 35.1%.

We can all agree that Loan A presents an acceptable risk of default. Loan B, on the other hand, has excessive risk layering that produces an unacceptable risk of default. Both mortgages, however, would carry the QRM stamp of approval and be released into the secondary market for resale. Exclusive reliance on single variable

[21] Claim rate refers to the expected probability of a claim being filed on an insured loan and is highly correlated with the risk of default of a loan.

tests (LTV at 80% or DTI at 36%) will not effectively eliminate the securitization of mortgages that carry an unacceptable risk of default.

It is well accepted that as LTV and DTI increase, the risk of default increases. However, even with LTV higher than 80% and DTI higher than 36%, if the other predictive variables contained in Loan A have improved risk characteristics, the risk of default is even lower than Loan A, the "normal QRM scenario." As illustrated in Exhibit A-2, consider the following additional examples:

Loan C: 97% LTV, 36% DTI, 760 credit score, purchase mortgage for a single family residence in Topeka, Kansas, 30-year fixed mortgage originated in the retail channel by a lender with an above average quality manufacturing process, no prior bankruptcies, and not self-employed. The claim rate for Loan C in a non-stressed economic environment is 0.5%. The claim rate in an extreme stressed economic environment is 1.8%.

Loan D: 80% LTV, 45% DTI, all other loan characteristics are the same as Loan C above. The claim rate for Loan D in a non-stressed economic environment is 0.2%. The clam rate in an extreme stressed economic environment is 0.7%.

Loan E: 97% LTV, 45% DTI, 740 credit score, all other loan characteristics are the same as Loan C above. The claim rate for Loan E in a non-stressed economic environment is 0.8%. The claim rate in an extreme stressed economic environment is 2.8%.

All of these examples present acceptable levels of risk, and though the risk of default is less than that of Loan A, the "normal QRM" eligible loan, none of these examples would qualify as QRM eligible. The claim rate in a normal economic environment is 10 times lower than that of Loan B, which would be QRM eligible when these loans would not be.

These examples are not just hypothetical, they are representative of the loans insured by MIs. Today's environment is similar to the environment during the 2002-2004 time period, and can be considered a normal economic environment. The 2006-2008 originations are considered to have experienced an extreme stressed economic environment. Exhibit A-4 and A-5 illustrate that the performance of loans originated in 2009 and 2010 and insured by United Guaranty is even better than the performance of loans during the 2002-2004 time period, which stands in stark contrast to the 2006-2008 vintages.

If the goal is to encourage origination and resale of mortgages with an acceptable risk of default, and at the same time to exclude from resale all mortgages with an unacceptable risk of default, the QRM definition is too narrow and does not achieve the desired result. Instead, a multi-variate approach that considers all of the characteristics of a loan should be employed.

The impact to the mortgage system of excluding from the definition of QRM loans with an acceptable risk of default is significant. From January 2010 through June 2011, United Guaranty alone insured 74,977 loans above 80% LTV, each one of which would not be QRM eligible. Exhibit A-3 shows the distribution of these loans and their expected claim rates. 77% of these loans carry a risk of default less than Loan A, but none of them would be QRM eligible. Publicly available information indicates that the expected claim rates for the loans insured by other MI's is similar, and would also be less than that of Loan A. These loans should be originated and should be securitized, but the current definition of QRM does not support that objective.

B. The Risk of Default Is Directly Correlated to the Quality of the Loan Origination Manufacturing Process

During the 2006-2008 time period, loans that defaulted at an excessive rate could be separated into two categories: either the information about the loan was accurate but there was too much layering of risk, or information about the loan was inaccurately reported and prevented accurate evaluation of the risk. Even if excessive risk layering is eliminated, defects in the loan origination manufacturing process will still prevent accurate evaluation of the risk and will result in a higher than desired default rate.

The quality of the manufacturing process varies amongst lenders, and so does the frequency of default. For example, early delinquency is a strong indicator of mortgage fraud. An originator's ability to identify and screen out mortgage fraud is reflected in early delinquency ratios. Evaluating a lender's manufacturing process in this way demonstrates a dramatic variance in the risk of default amongst these lenders. (Exhibit B-2). All else being equal, those lenders with a lower early delinquency ratio, and with a better manufacturing process that allows for accurate evaluation of each loan, produce loans with a lower risk of default.

For purposes of illustration, lenders can be separated into a tiered hierarchy based on the early delinquency ratios of the loans they originate. (Exhibit B-1). We listed the early delinquency ratios by lender for 57 lenders, and assigned a score based on their manufacturing quality. We then grouped the lenders into five categories. Exhibit B-2 illustrates the dramatic difference in the risk of default based solely on the identity of the lender, *all else being equal.*

A more extreme example is illustrated in Exhibit B-3, which compares the performance of loans originated during the same time period and using the same basic underwriting guidelines, but originated by two different lenders.

The proposed QRM definition will treat all lenders equally, and will not capture the connection between the quality of the manufacturing process and the frequency of

default. The average loss from a high LTV loan is approximately $100,000, half of which is suffered by the investors and half of which is covered by MI in today's stressed economic environment, making each error in the manufacturing process a very costly one.

III. MI Reduces The Frequency Of Default

MI meets Congress' express goal of ensuring incentive alignment when mortgages are securitized into residential mortgage-backed securities (MBS)[22] because an MI firm puts its private capital at risk for every mortgage it insures. High LTV Loans with properly underwritten MI are expected to perform at least as well as those defined as QRM when other factors are evaluated.[23]

A. MI Second Look Improves the Quality of Loans Selected for Securitization

A critical feature of MI is that it is generally underwritten prior to loan closing and it acts as a "second look" at the loan risk characteristics for the lender as well as the investor. Because the quality of the manufacturing process is directly correlated to the quality of the loans produced, any improvement in the manufacturing process will lower the risk of default of the loans released into the secondary market for investment. A recent FHFA report validated this conclusion by stating that, "Mortgage insurers now control risk from new loans through tightened underwriting standards and restrictions on insuring properties in higher risk markets".[24]

MIs provide a second look in the underwriting process as a backstop that equalizes the difference between the quality of the manufacturing process at different lenders. Only MIs provide this second look, no other entity reviews loans originated by lenders at any time in the origination process or the securitization process.

While it may not be necessary to look at every document in every loan file, a prudent MI underwriting process cannot be accomplished by exclusive use of automated underwriting systems. A complete and accurate file, and the ability to review and evaluate the information are critical components of a prudent process.

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[22] Senator Christopher Dodd, *speech before the United States Senate*, Congressional Record (May 11, 2010) S3518, "[A] skin-in-the game requirement that creates incentives that encourage sound lending practices, restores investor confidence, and permits securitization markets to resume their important role as a source of credit for households and businesses."

[23] Exhibits A-1, A-2 and A-3

[24] Federal Housing Finance Agency, *2010 Report to Congress* (June 13, 2011) p. 20, *available at*: http://www.fhfa.gov/webfiles/21570/FHFA2010RepToCongress61311.pdf.

When an MI firm receives and underwrites a loan file from an originator, one of four underwriting decisions is initially made:

- Approved: The loan file is complete and contains accurate information, and evaluation shows the risk of default is acceptable;
- Conditional Approval: The loan file is accurate and only missing a limited number of pieces of information. If those last pieces of information are obtained and are acceptable, the loan is approved;
- Manufacturing Defects: The loan either contains inaccurate information or is missing so much information that an accurate evaluation of the risk cannot be made;
- Denied: The loan is determined to either be fraudulent or the risk of default is so high it is considered uninsurable.

From July 2010 through May 2011, United Guaranty has initially approved only one quarter of the loans submitted to it. Approximately 60% of the loans submitted were missing information necessary for an accurate evaluation of risk. Nearly 10% of the loans submitted were denied as either fraudulent or so risky they are uninsurable. Loan file quality varies dramatically by originator, as some originators almost always submit complete and accurate files and other lenders almost never submit complete and accurate files on their first submission. (Exhibit B-4).

Loans that are approved by Fannie Mae as eligible for purchase, and which would be exempt from the QRM requirements, would not always be approved by an MI underwriter. If the characteristics meet the GSE automated underwriting guidelines, approval is granted with the push of a button. However, only a person looking at the full risk profile contained in a complete and accurate file would notice risk characteristics such as multiple late payments over a two year period, or that the borrower is in credit counseling, or that a recent serious delinquency is noted in the credit report. (Exhibit B-5).

These statistics are telling in a market where the majority of loans are prime mortgages originated in compliance with GSE guidelines, and demonstrate the continuing defects in the manufacturing process at loan originators, and the need for a thorough second review to ensure the quality of the loans being originated. These weaknesses in origination processes are further evidenced in recent articles describing substandard lender origination practices relating to loan quality in underwriting.[25]

The old system allowed lenders to originate and resell mortgages with representations and warranties that the loans had been prudently underwritten. Generally, there was no thorough review in advance of those loans being released

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[25] Evan Nemeroff, U.S. Sues Deutsche Bank for 'Reckless' FHA Lending Practices, American Banker, (May 4, 2011), available at http://www.americanbanker.com/issues/176_85/deutsche-fha-lending-practices-1037024-1.html

into the secondary market. The pending rewrite of mortgage securitization seeks to strengthen these representations and warranties, and United Guaranty supports these efforts. While a put-back after foreclosure protects investors somewhat (when the put-back is successful), a second look at origination by a mortgage insurer protects both the borrower and the investor. The QRM requirements impose standards for prudent underwriting, but do not address operational deficiencies in the manufacturing process itself. If MIs do not perform the second look, and lenders do not flawlessly comply with QRM requirements, there may be no consequence to the lender or the securitizer but borrowers and investors are put at undue risk. MIs are in a first-loss position, and with private capital at risk, have the proper incentives to critically review loans submitted for MI to ensure compliance with underwriting criteria. The positive outcome of this process will be reduced frequency of default for QRM eligible loans.

B. Mortgage Insurers Employ Superior Risk Management Expertise That Improves the Risk Quality of Loans Originated

Since the crisis, a new MI business model has developed that emphasizes risk management and front end underwriting decisions made independent of automated underwriting approvals produced by GSE models. Beginning in late 2008, our industry made several changes to ensure that only quality loans meeting tighter underwriting guidelines would be insured. Loans originated with greater than 80% LTVs and sold to the GSEs must now also meet these strict requirements, meaning that MIs often impose higher standards than the GSEs. The performance of earlier vintages, such as the 2006 book, compared to the 2009 book of business, illustrates the improvement in the quality of new loans with MI as a result of better risk management.[26]

No longer relying on GSE-defined underwriting standards, MIs have developed independent, reliable and flexible risk management capabilities. Risk management is a specialized expertise, and because they are in a first loss position, MIs are the only player in the entire mortgage origination chain with the financial incentive to employ this expertise. Loan originators are motivated by volume, and GSEs are subject to political and other pressures. MIs have the flexibility to change their risk "box" within the GSEs' standard underwriting guidelines or the QRM underwriting requirements as risk varies in specific risk cells.

The risk that a loan will default is driven by several categories of risk, including: risk characteristics of the borrower, the property, the loan, the quality of the loan origination manufacturing process and macro-economic risks such as declines in housing prices in the market.

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[26] See Exhibits A-4 and A5.

Of the above categories of risk, the risk of housing price decline is the only characteristic that changes over time and varies by location. This presents a challenge in establishing appropriate underwriting guidelines, because the guidelines must be flexible and must change as market conditions change. If there is an increase in the risk of housing price decline, then a corresponding decrease in the other risk characteristics is necessary to prevent an increase in the overall risk of default.

A stark example of the importance of including the risk of housing price decline in the evaluation of a loan is illustrated in Exhibits C-1 and C-2. Due to housing price fluctuations, a loan originated today in Daytona Beach, Florida is more than twice as likely to default as the very same loan originated in South Bend, Indiana. A loan originated today in Daytona Beach, Florida is more than twice as likely to default as the very same loan originated in Daytona Beach, Florida in 2002:

	Daytona Beach		South Bend	
	Classification	Claim Rate	Classification	Claim Rate
2002	Stable	0.9%	Stable	0.9%
Today	High-Risk	2.6%	Stable	0.9%

A single set of fixed underwriting eligibility guidelines will not address the variance in risk over time because the macro-economic conditions change and make those underwriting guidelines no longer applicable or effective. At any given time, the fixed guidelines will either be too tight or too loose.

Instead, the only effective way to prevent an increase in the risk of default when macro-economic risks increase is to employ a mechanism that quickly tightens underwriting guidelines for other risk categories. The dynamic interaction of the risk variables in a changing environment is essential to preventing an increase in the risk of default. MI provides the capability and the motivation to quickly adjust underwriting guidelines as necessary, because its capital is in the first loss position and it will act quickly to make the changes in a responsible manner.

C. MIs Have Financial Incentives to Facilitate Loan Modifications to Avoid Default

In assessing the risk of mortgage default, it is important to distinguish between delinquency and default on a mortgage loan obligation. A delinquency status reflects a late payment that can be cured as borrowers become current either on their own or with repayment plans and structured modifications. MIs play a prominent role in assisting borrowers with these loan modifications and repayment plans. MIs are financially aligned with borrowers, lenders, investors and ultimately taxpayers to find ways to keep homeowners in their homes. If the delinquent loans cure or are modified, the MI does not pay a claim and retains insurance (and collects

premium) on the now performing loan. MIs thus have a direct financial incentive to assist the borrower in curing their delinquency.

United Guaranty has been very active in preventing borrowers in delinquency from slipping into default and ultimately losing their home. Exhibit D-1 shows United Guaranty and MICA's respective delinquency cure rates which show continued improvement in the reduction of ultimate defaults. Additionally, throughout the crisis, MIs performed a responsible role with government stakeholders in establishing homeowner assistance programs. United Guaranty data support the conclusion that mortgage insurance reduces risk of default and risk of loss.[27]

IV. A Revised QRM is Critical To Improved U.S. Housing Policy

A. The Current Framework of Risk Retention Will Create Perverse Incentives

Under the proposal, the cost of risk retention will be shouldered by borrowers already struggling to meet down payment requirements, while also adding compliance costs to overburdened originators. Many industry stakeholders have attempted to estimate the costs of risk retention that ultimately will be passed on to the consumer. These estimates vary because of the widely different business models and regulatory structures of originators and securitizers. Some of the estimates range from the low-cost (e.g., 10-15 [28] to 75 basis points[29]) applicable to securitizers immune from regulatory-capital requirements to the higher cost (e.g., 100[30] to 300 basis points[31]) applicable to regulated originators and issuers who will shoulder the operational aspects of implementing restrictive criteria as well as the hard dollar capital costs.

The QRM as proposed creates an incentive for high-risk Non-QRM originations. Because of the strict QRM criteria, lenders will have no incentive to work with borrowers to increase downpayments or to require MI on high-LTV mortgages to protect investors, as doing so alone will not win QRM classification. This Non-QRM market might be liquid, as regulators contend, but the liquidity will come only from the large volumes of poorly-underwritten loans funneling through it. Indeed, because risk must be retained for the life of the loan on all loans outside of the rules,

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[27] See Interagency Proposed Rule, *supra* note 1, question 111(a).
[28] http://www.bankinvestmentconsultant.com/news/FDIC-banks-risk-management-QRM-2673729-1.html?utm_source=mortgagenewsclips+test+list&utm_campaign=033b317950-RSS_EMAIL_CAMPAIGN&utm_medium=email
[29] Kenneth Harney, *QRM May Spell Mortgage Trouble,* Miami Herald, (Apr. 10, 2011) *available at* http://www.miamiherald.com/2011/04/10/2157388/qrm-may-spell-mortgage-trouble.html.
[30] Mark Zandi, Reworking Risk Retention 6/21/11
[31] JP Morgan Securities Inc., *Securitization Outlook* (Dec. 11, 2009) published by JP Morgan Securities.

the proposed definition provides little incentive for lenders to originate an 80.01 LTV purchase mortgage with MI when they can offer a 100 LTV mortgage without MI to be kept in portfolio or a high-LTV loan insured by the Federal Housing Administration (FHA) which is exempt from the risk-retention requirements.

B. Creditworthy Borrowers Should Have Access to Credit

MIs are private capital standing in front of taxpayers as the GSEs wind down.[32] As the housing crisis subsides, the Administration's stated policy is to reduce the market share of the FHA and GSEs. Today, available private MI capital would enable financial markets to originate 1.3 million insured low down payment loans annually for the next three years[33] and represents private capital willing to facilitate prudent lending on higher LTV mortgages, as extraordinary government housing programs are wound down. We believe that improving the stability of the financial system with responsible criteria will ensure that taxpayers will never have to fund another bailout.

Consumer interests will not be served if able and willing borrowers cannot obtain competitive financing and/or must wait years to save the 20 percent downpayment. The implementation of the proposed QRM definition, along with ongoing GSE and FHA changes in guidelines and eligibility, will unnecessarily contract credit and shrink the available pool of creditworthy borrowers, reducing housing demand. Reduced demand at this critical time will slow the housing recovery.

An example of credit contraction has recently occurred in the condominium (condo) markets where the GSEs have reduced their participation in the financing of new and existing loans, citing concerns over delinquency concentration and investment property concentration. This credit contraction has essentially frozen condo sales in affected markets, resulting in declining values and secondary effects to the housing sector of the economy. Mortgage insurers have the ability to provide flexible guidelines, when appropriate, to enable prudent lending in these circumstances.

United Guaranty believes that the exemption for GSE guaranteed business should remain to allow continuity and liquidity to the marketplace during the GSE wind down and the transformation of the housing finance system in the wake of the Dodd-Frank Act.[34] United Guaranty does not believe that servicing standards should be part of the QRM definition as it is outside the intended purpose of the QRM definition and it is addressed in other areas of proposed legislation.

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[32] See Interagency Proposed Rule, *supra* note 1, question 111(a).
[33] Mortgage Insurance Companies of America (MICA), *Statement By MICA* (Mar. 24, 2011) *available at:* http://www.privatemi.com/news/statements/20110324.cfm.
[34] See Interagency Proposed Rule, *supra* note 1, at 24,154.

Conclusion

In this letter, United Guaranty has provided data demonstrating that the QRM as written imposes unnecessary and restrictive criteria that are not required for prudent lending and eliminates efficient, prudent financing for creditworthy borrowers who lack substantial downpayments. These borrowers can sustain home ownership over time, building families and supporting communities if high-LTV lending is done prudently with MI, and backed by private capital that ensures effective long-term incentive alignment between originators and securitizers on the one hand and borrowers and investors on the other.

These data and the qualitative information we have respectfully provided to the Agencies make clear that the QRM should not be as narrowly drawn as proposed and that private MI must be a criterion for all high-LTV loans provided QRM eligibility.

United Guaranty would be pleased to answer any questions the Agencies may have or to provide additional data supporting the representations made herein.

Sincerely,

R. Eric Martinez Jr.

Eric Martinez, Chief Executive Officer
United Guaranty Corporation

Exhibit A-1: QRM Admits High-Risk Loans

Normal QRM Scenario (Loan A)

Variable	
80% LTV	
36% DTI	
700 Credit Score	
Loan Purpose: Purchase	
Property Type: Single Family	
Loan Type: Fixed	
Loan Term: 30 years	
Originator Type: Retail	
Lender Quality Index: Average National Lender	
Self Employment: No	
Prior Bankruptcy: No	
Geographic Risk: Stable (South Bend, IN)	
Normal Economic Environment Claim Rate	**0.9%**
Severely Stressed Economic Environment (2006-2008) Claim Rate	**4.1%**

Upper Bound QRM Scenario (Loan B)

Variable	
80% LTV	
36% DTI	
660 Credit Score	
Loan Purpose: Purchase	
Property Type: Urban Condo	
Loan Type: Fixed	
Loan Term: 30 years	
Originator Type: Broker	
Lender Quality Index: Below Average	
Self Employment: Yes	
Prior Bankruptcy: Yes	
Geographic Risk: High Risk Area (Daytona Beach, FL)	
Normal Economic Environment Claim Rate	**10.1%**
Severely Stressed Economic Environment (2006-2008) Claim Rate	**35.1%**

Exhibit A-2: QRM Excludes High-Quality Loans

Scenario 1 (Loan C) Violating QRM's LTV Threshold		Scenario 2 (Loan D) Violating QRM's DTI Threshold		Scenario 3 (Loan E) Violating both QRM's LTV & DTI Thresholds	
Variable		Variable		Variable	
97% LTV		80% LTV		97% LTV	
36% DTI		45% DTI		45% DTI	
760 Credit Score		760 Credit Score		740 Credit Score	
Loan Purpose: Purchase		Loan Purpose: Purchase		Loan Purpose: Purchase	
Property Type: Single Family		Property Type: Single Family		Property Type: Single Family	
Loan Type: Fixed		Loan Type: Fixed		Loan Type: Fixed	
Loan Term: 30 years		Loan Term: 30 years		Loan Term: 30 years	
Originator Type: Retail		Originator Type: Retail		Originator Type: Retail	
Lender Quality Index: Above Average		Lender Quality Index: Above Average		Lender Quality Index: Above Average	
Self Employment: No		Self Employment: No		Self Employment: No	
Prior Bankruptcy: No		Prior Bankruptcy: No		Prior Bankruptcy: No	
Geographic Risk: Better than Stable (Topeka, KS)		Geographic Risk: Better than Stable (Topeka, KS)		Geographic Risk: Better than Stable (Topeka, KS)	
Normal Economic Environment Claim Rate	**0.5%**	**Normal Economic Environment Claim Rate**	**0.2%**	**Normal Economic Environment Claim Rate**	**0.8%**
Severely Stressed Economic Environment (2006-2008) Claim Rate	**1.8%**	**Severely Stressed Economic Environment (2006-2008) Claim Rate**	**0.7%**	**Severely Stressed Economic Environment (2006-2008) Claim Rate**	**2.8%**

Exhibit A - 3: 77% of UGC Insured Loans Are Of Higher Quality Than QRM Baseline

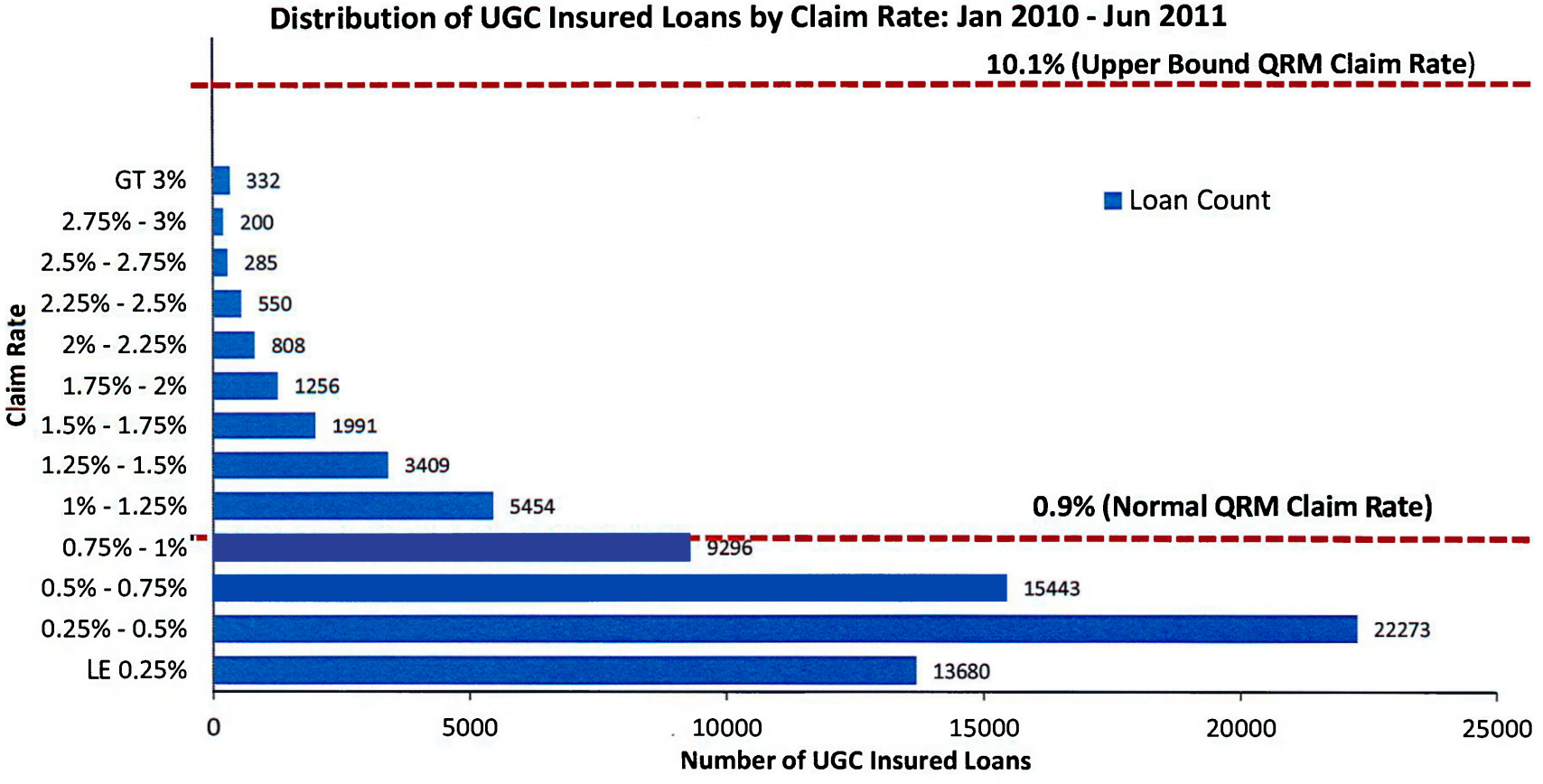


Exhibit A-4 UGC Delinquency Emergence Pattern by Origination Year

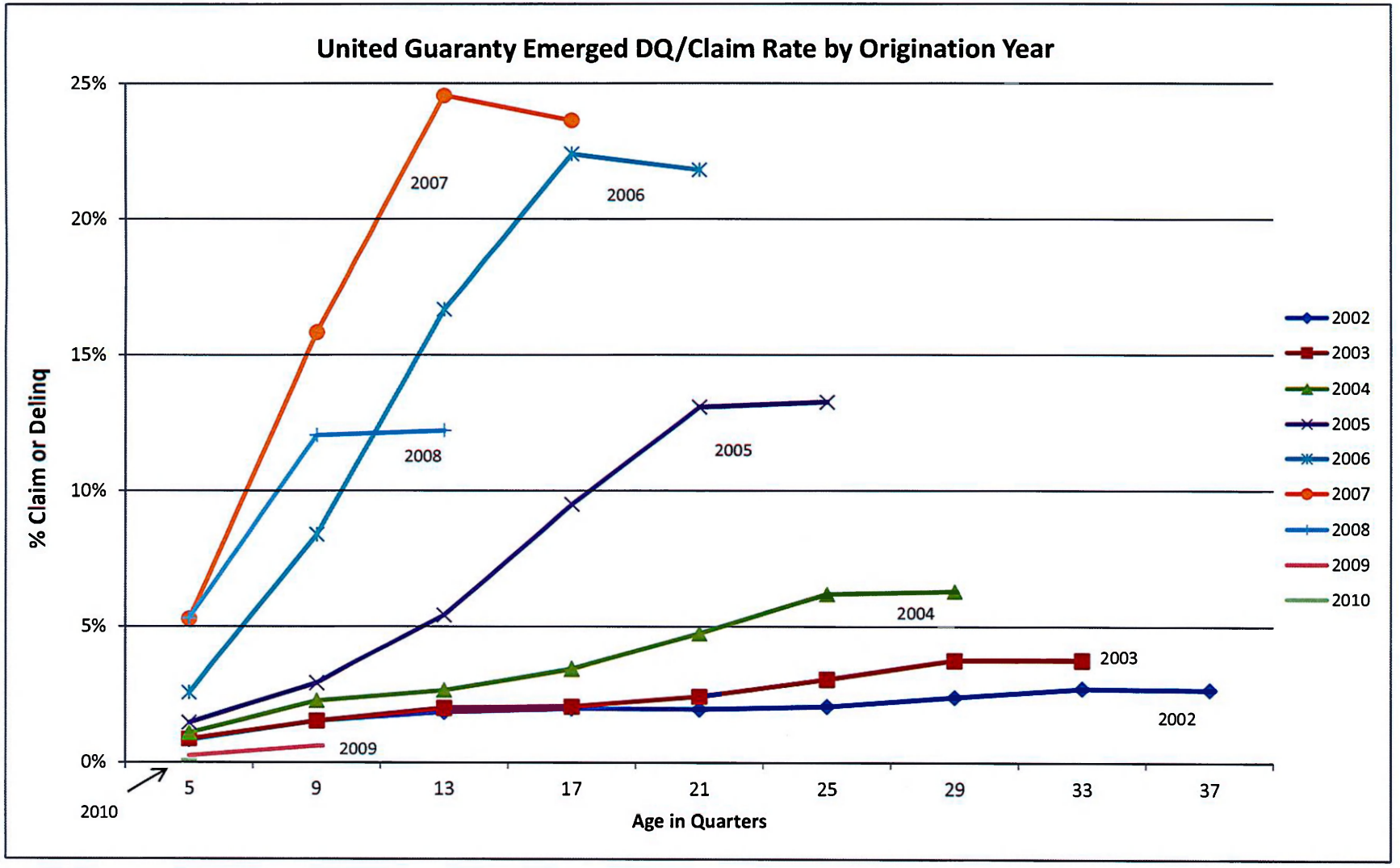


Exhibit A-5: UGC Delinquency Emergence Pattern by Origination Year by Quarter

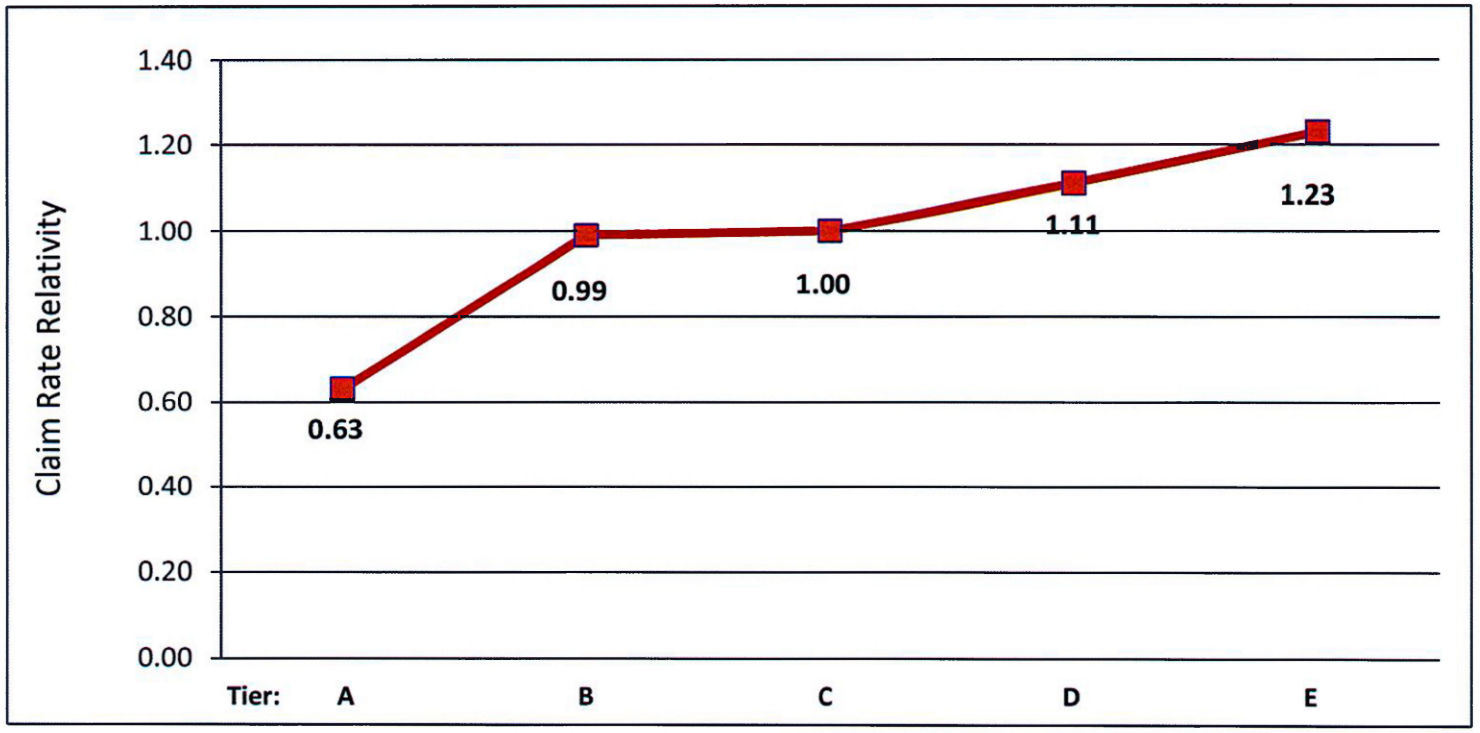
Delinquency Ratio, Origination Years 2002 - 2010

	Age in quarters											
Origination Year	1	2	3	4	5	6	7	8	9	10	11	12
2002	0.0%	0.2%	0.5%	0.6%	0.9%	1.2%	1.8%	2.2%	2.5%	2.9%	3.4%	3.8%
2003	0.0%	0.2%	0.4%	0.7%	0.9%	1.2%	1.6%	1.9%	1.9%	2.1%	2.5%	3.1%
2004	0.0%	0.3%	0.6%	0.9%	1.2%	1.6%	2.2%	3.1%	2.9%	3.1%	3.5%	3.8%
2005	0.0%	0.3%	0.6%	1.3%	1.4%	1.9%	2.6%	3.2%	3.3%	3.9%	4.8%	6.0%
2006	0.0%	0.6%	1.2%	2.0%	2.8%	4.6%	6.4%	8.5%	9.5%	11.9%	14.4%	17.6%
2007	0.2%	1.1%	2.4%	3.9%	5.3%	7.8%	10.5%	14.3%	16.6%	19.7%	24.0%	27.1%
2008	0.0%	0.9%	2.1%	3.6%	5.1%	6.9%	9.3%	11.4%	12.2%	12.3%	12.3%	11.5%
2009	0.0%	0.1%	0.1%	0.2%	0.2%	0.2%	0.4%	0.5%	0.6%	0.6%		
2010	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%						

Exhibit B-1: Detail of Early Deliquency Ratio and Lender Quality Score for High Volume Lenders

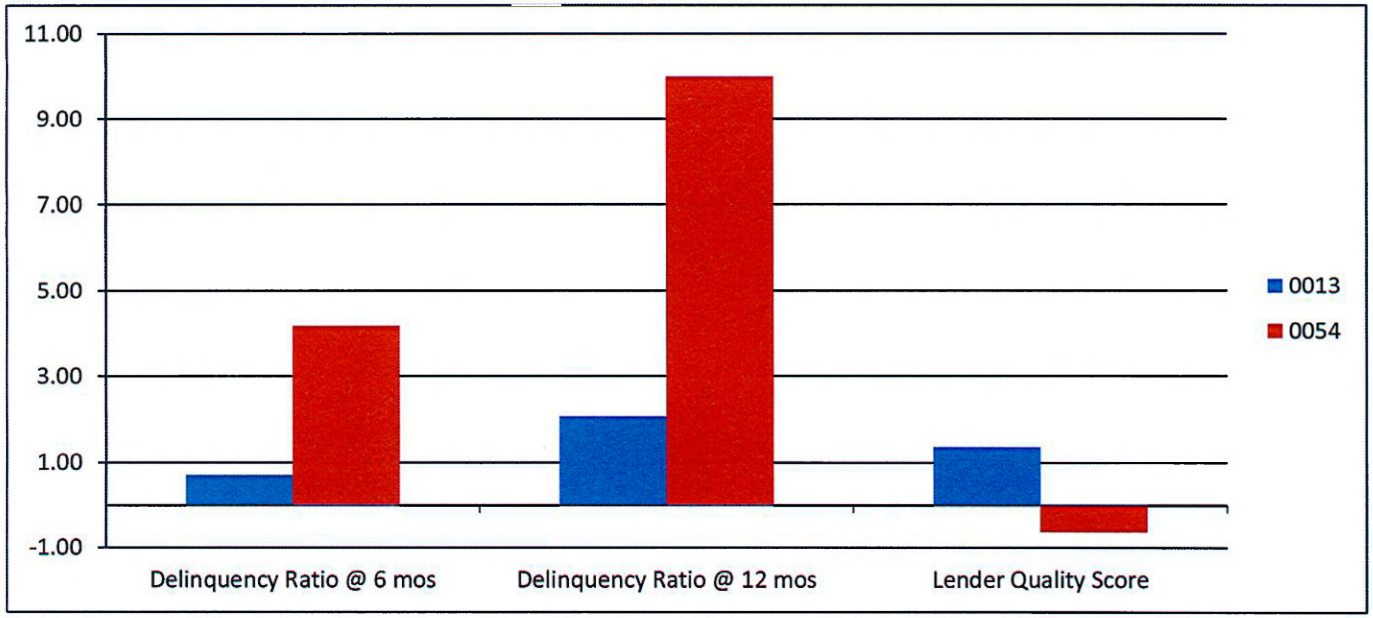
Lender	Delinquency Ratio As of 6 Months 2006-2008	Delinquency Ratio As of 12 Months 2006-2008	Lender Quality Score	Lender Quality Tier
0001	0.00%	0.00%	1.79	A
0002	0.00%	0.00%	1.73	A
0003	0.00%	0.00%	1.65	A
0004	0.00%	0.00%	1.59	A
0005	0.00%	0.48%	1.50	A
0006	0.00%	0.00%	1.49	A
0007	0.00%	0.74%	1.49	A
0008	0.00%	0.00%	1.46	A
0009	0.00%	0.43%	1.45	A
00010	0.30%	0.30%	1.44	A
00011	0.16%	0.32%	1.41	A
00012	0.00%	0.22%	1.40	A
00013	0.71%	2.07%	1.37	A
00014	0.51%	1.80%	1.31	A
00015	0.14%	1.57%	1.30	A
00016	0.27%	1.86%	1.20	A
00017	0.40%	2.06%	1.19	A
00018	1.00%	2.06%	1.18	A
00019	0.95%	2.37%	1.10	A
00020	1.27%	3.27%	1.09	A
00021	0.85%	3.30%	1.02	A
00022	1.22%	3.92%	1.01	A
00023	0.95%	4.19%	0.99	A
00024	1.55%	4.73%	0.97	B
00025	1.82%	5.01%	0.97	B
00026	1.61%	4.30%	0.92	B
00027	0.91%	4.05%	0.89	B
00028	1.49%	2.97%	0.86	B
00029	1.06%	3.95%	0.74	B
00030	1.56%	6.85%	0.67	B
00031	1.97%	4.70%	0.65	B
00032	1.56%	5.16%	0.64	B
00033	2.13%	5.27%	0.58	B
00034	2.46%	6.05%	0.58	B
00035	1.13%	4.54%	0.52	B
00036	2.72%	4.81%	0.50	B
00037	2.70%	5.85%	0.49	C
00039	1.37%	3.58%	0.37	C
00040	2.43%	6.14%	0.35	C
00041	4.23%	7.77%	0.31	C
00042	5.14%	9.38%	0.21	C
00043	2.69%	7.31%	0.15	C
00044	2.60%	5.78%	0.02	C
00045	1.59%	6.80%	0.01	C
00046	3.76%	7.02%	-0.12	C
00047	4.43%	9.92%	-0.13	C
00048	2.81%	7.53%	-0.18	C
00049	3.71%	9.08%	-0.25	C
00050	3.82%	11.55%	-0.28	C
00051	3.23%	7.59%	-0.41	C
00052	3.00%	7.85%	-0.44	C
00053	4.73%	11.50%	-0.53	D
00054	4.17%	10.00%	-0.64	D
00055	4.14%	10.52%	-1.03	E
00056	5.11%	12.13%	-1.19	E
00057	6.09%	13.37%	-1.33	E

Exhibit B-2 - Comparison of Claim Rate Relativity by Lender Quality Tier



The claim rate relativity is the indicated variation in claim rate due solely to variation in lender manufacturing quality. Lender performance analysis is critical to the risk evaluation process.

Exhibit B-3: Comparison of Lenders in Two Different Quality Tiers



Lender	% Delinquency Ratio @ 6 mos	% Delinquency Ratio @ 12 mos	Lender Quality Score	Lender Quality Tier
0013	0.71	2.07	1.37	A
0054	4.17	10.00	-0.64	D

This Exhibit shows the stark comparison of two different lenders over the same timeframe and using the same underwriting guidelines with the resulting performance of their loans.

Exhibit B-4: Initial Underwriting Approval Percentages By Lender For Sample Region From Jan - Jun 2011

Lender	Number of Loan Applications	% Initial Approval
Lender 1	5	80.0%
Lender 2	7	71.4%
Lender 3	19	68.4%
Lender 4	9	55.6%
Lender 5	70	50.0%
Lender 6	12	50.0%
Lender 7	25	48.0%
Lender 8	11	45.5%
Lender 9	9	44.4%
Lender 10	7	42.9%
Lender 11	10	40.0%
Lender 12	5	40.0%
Lender 13	5	40.0%
Lender 14	5	40.0%
Lender 15	13	38.5%
Lender 16	8	37.5%
Lender 17	6	33.3%
Lender 18	6	33.3%
Lender 19	6	33.3%
Lender 20	13	30.8%
Lender 21	7	28.6%
Lender 22	25	28.0%
Lender 23	11	27.3%
Lender 24	12	25.0%
Lender 25	36	22.2%
Lender 26	9	22.2%
Lender 27	9	22.2%
Lender 28	5	20.0%
Lender 29	5	20.0%
Lender 30	5	20.0%
Lender 31	5	20.0%
Lender 32	5	20.0%
Lender 33	5	20.0%
Lender 34	5	20.0%
Lender 35	5	20.0%
Lender 36	5	20.0%
Lender 37	5	20.0%
Lender 38	11	18.2%
Lender 39	11	18.2%
Lender 40	6	16.7%
Lender 41	6	16.7%
Lender 42	13	15.4%
Lender 43	7	14.3%
Lender 44	7	14.3%
Lender 45	31	12.9%
Lender 46	11	0.0%
Lender 47	9	0.0%
Lender 48	6	0.0%
Lender 49	5	0.0%
Lender 50	5	0.0%

Exhibit B-5: DU Underwriting Versus MI Underwriting

Loan Details

Loan Amount:	$323,000
LTV:	95%
Location:	Rockwall, TX
Loan Purpose:	Purchase
Note Rate:	5.0%
FICO:	680

DU Underwriting Findings:

- "The risk profile of this loan casefile appears to meet Fannie Mae's guidelines."
- "This loan casefile appears to meet Fannie Mae's eligibility requirements."
- "The following risk factors represent strengths in the borrower's loan application: loan purpose (purchase)."

DU decision: Approve Eligible

United Guaranty Findings:

- Borrower has multiple and significant late payment instances in 2008 and 2009
- Borrower is currently in credit counseling
- Borrower has a foreclosure / judgment for a construction loan in 2009 for $10,000; judgment was paid off in 2009
- Notes from credit report that adversely affected borrower score:
  - Serious delinquency, and public record / collection filed
  - Time since delinquency is too recent
  - Length of time since derogatory public record / collection is too short
  - Number of accounts with delinquency

United Guaranty decision: Decline

Exhibit C-1

South Bend-Mishawaka, IN-MI **GQX = A** Effective Aug. 15, 2011

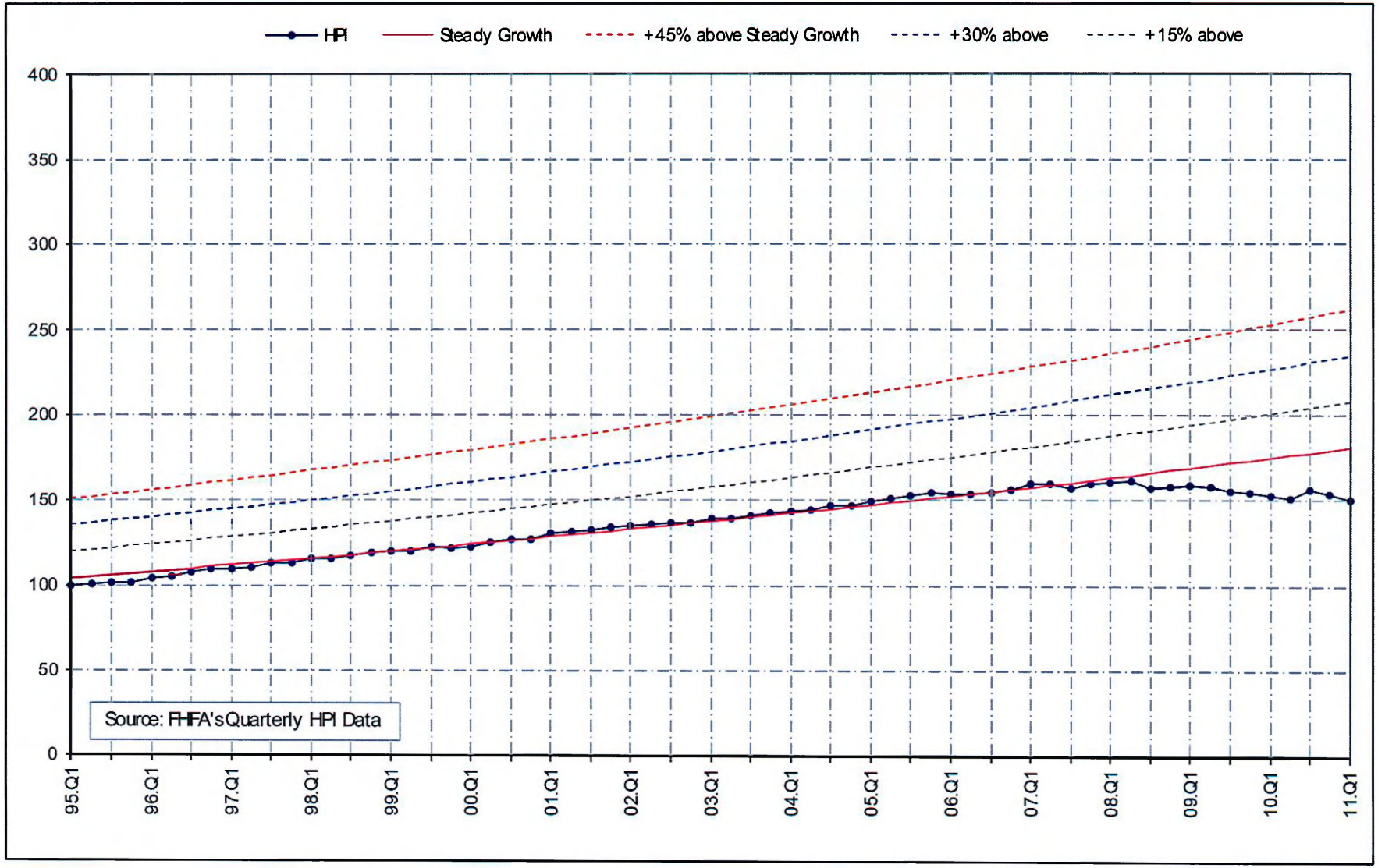


Exhibit C-2

Deltona-Daytona Beach-Ormond Beach, FL **GQX = D** Effective Aug. 15, 2011

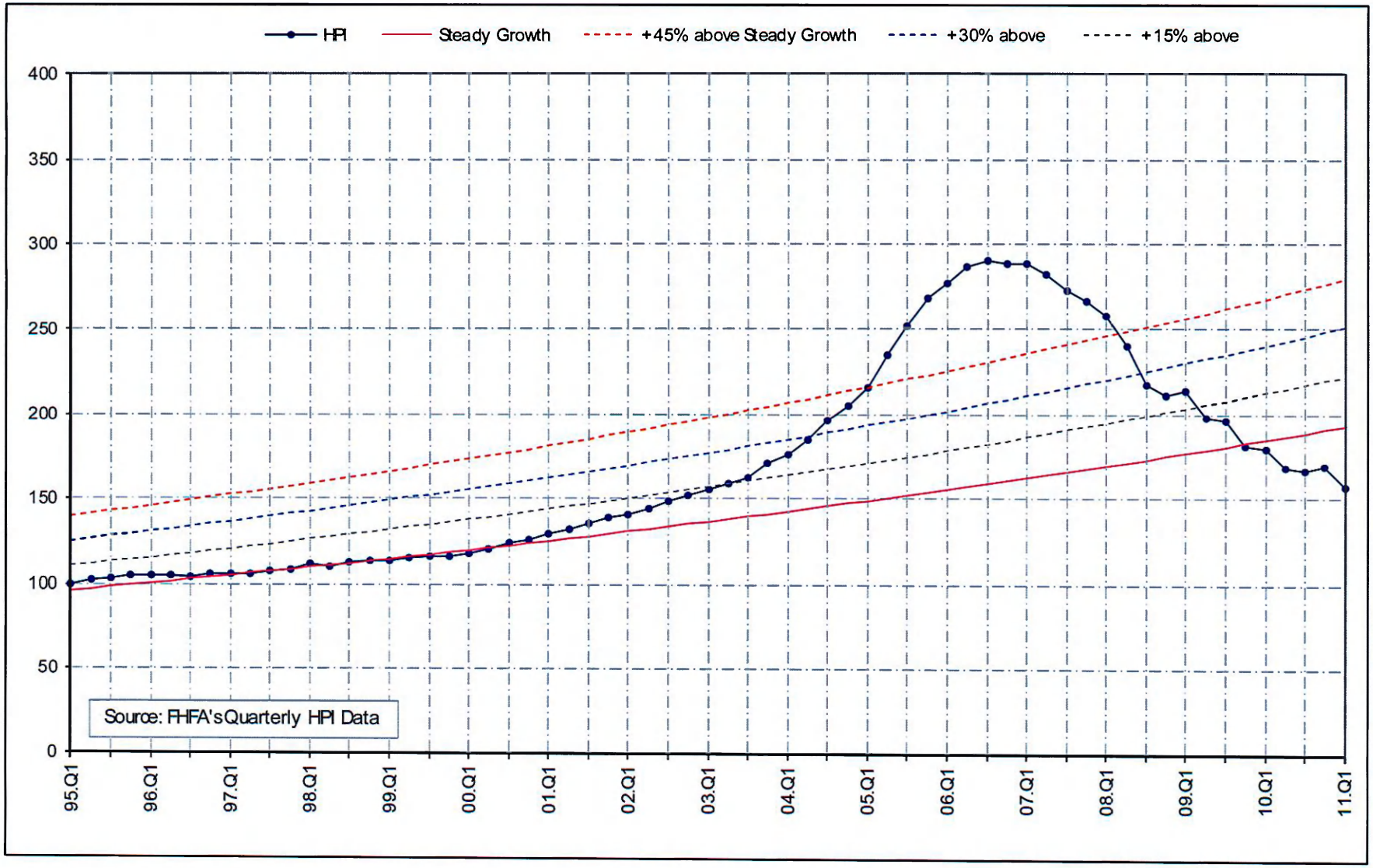


Exhibit C-3

Topeka, KS **GQX = A** Effective Aug. 15, 2011

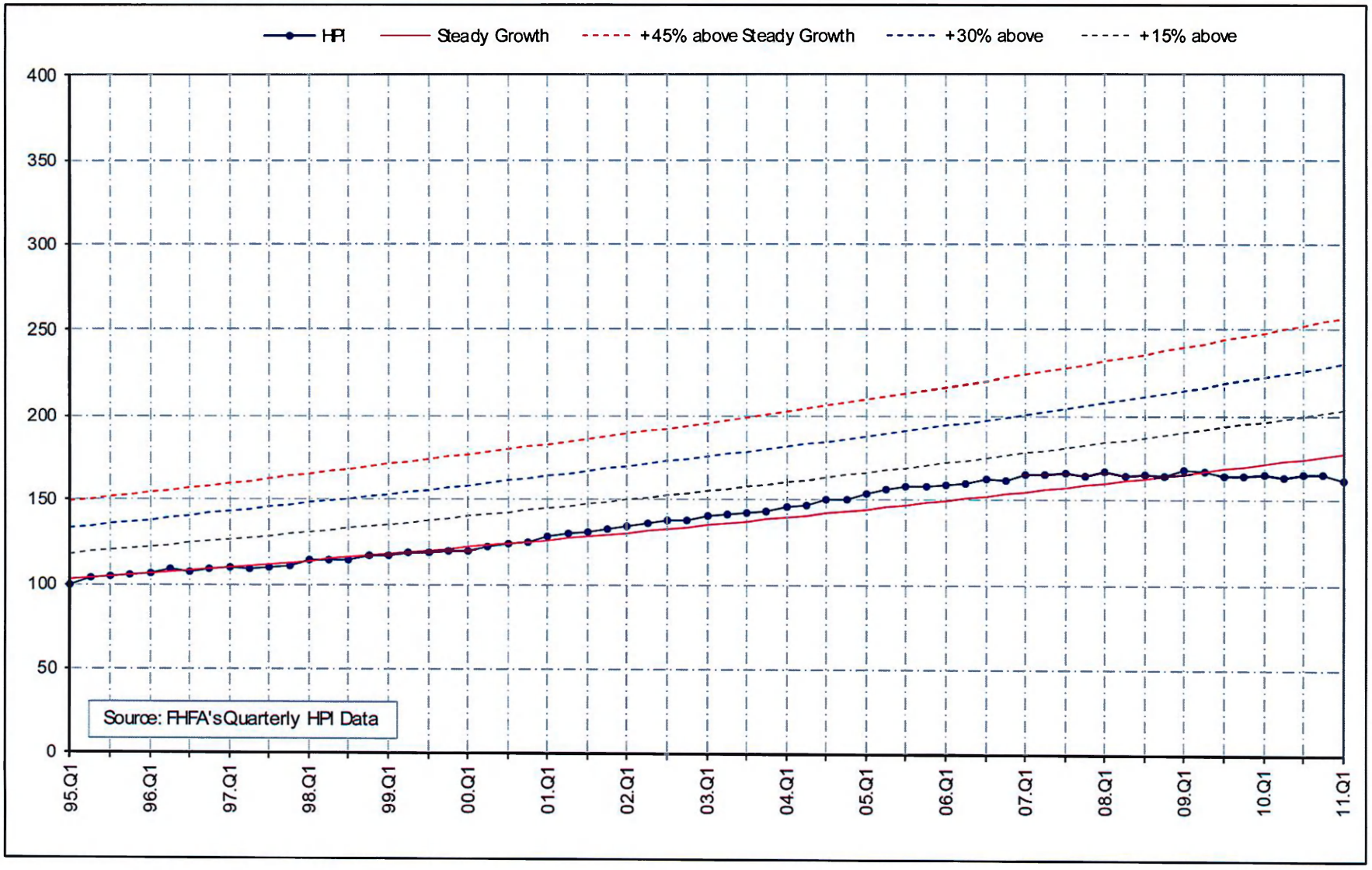
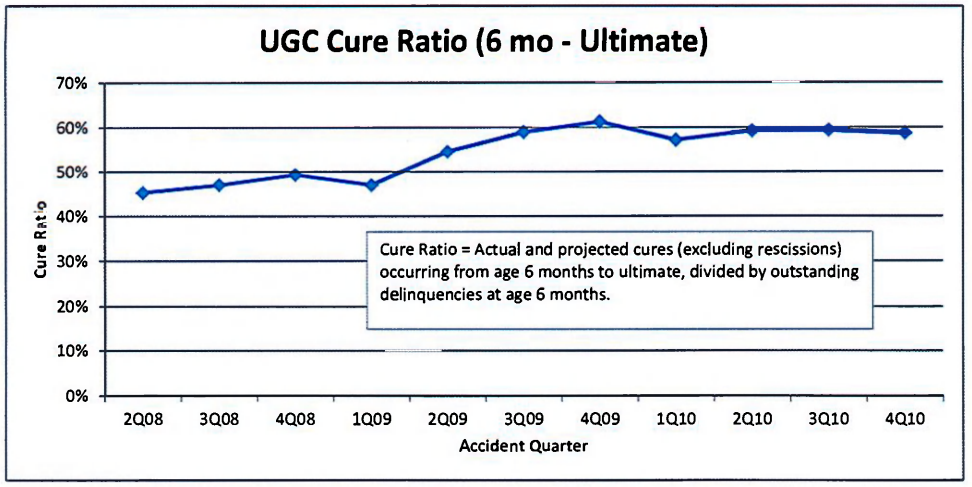


Exhibit D-1: Loan Delinquency Cure and Cure Ratio Statistics



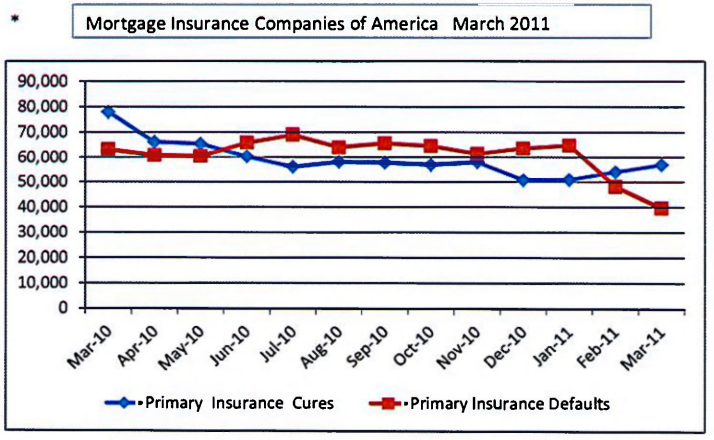
UGC works with servicers to assist in home retention wherever possible. Trends continue to show improvement in workout activities as well as reduced delinquencies as shown in the MICA data below.

Mortgage Insurance Companies of America
Private Mortgage Insurance Activity
March 2011

*

Period	Primary Insurance Cures	Primary Insurance Defaults	Ratio
Mar-10	77,909	63,126	123.4%
Apr-10	66,170	60,656	109.1%
May-10	65,436	60,346	108.4%
Jun-10	60,337	65,792	91.7%
Jul-10	56,086	68,862	81.4%
Aug-10	58,094	63,882	90.9%
Sep-10	57,720	65,481	88.1%
Oct-10	56,887	64,450	88.3%
Nov-10	58,015	61,262	94.7%
Dec-10	50,707	63,519	79.8%
Jan-11	50,820	64,687	78.6%
Feb-11	53,944	48,086	112.2%
Mar-11	56,934	39,557	143.9%

*



*Note: UGC data was not part of MICA cure reporting in February and March 2011